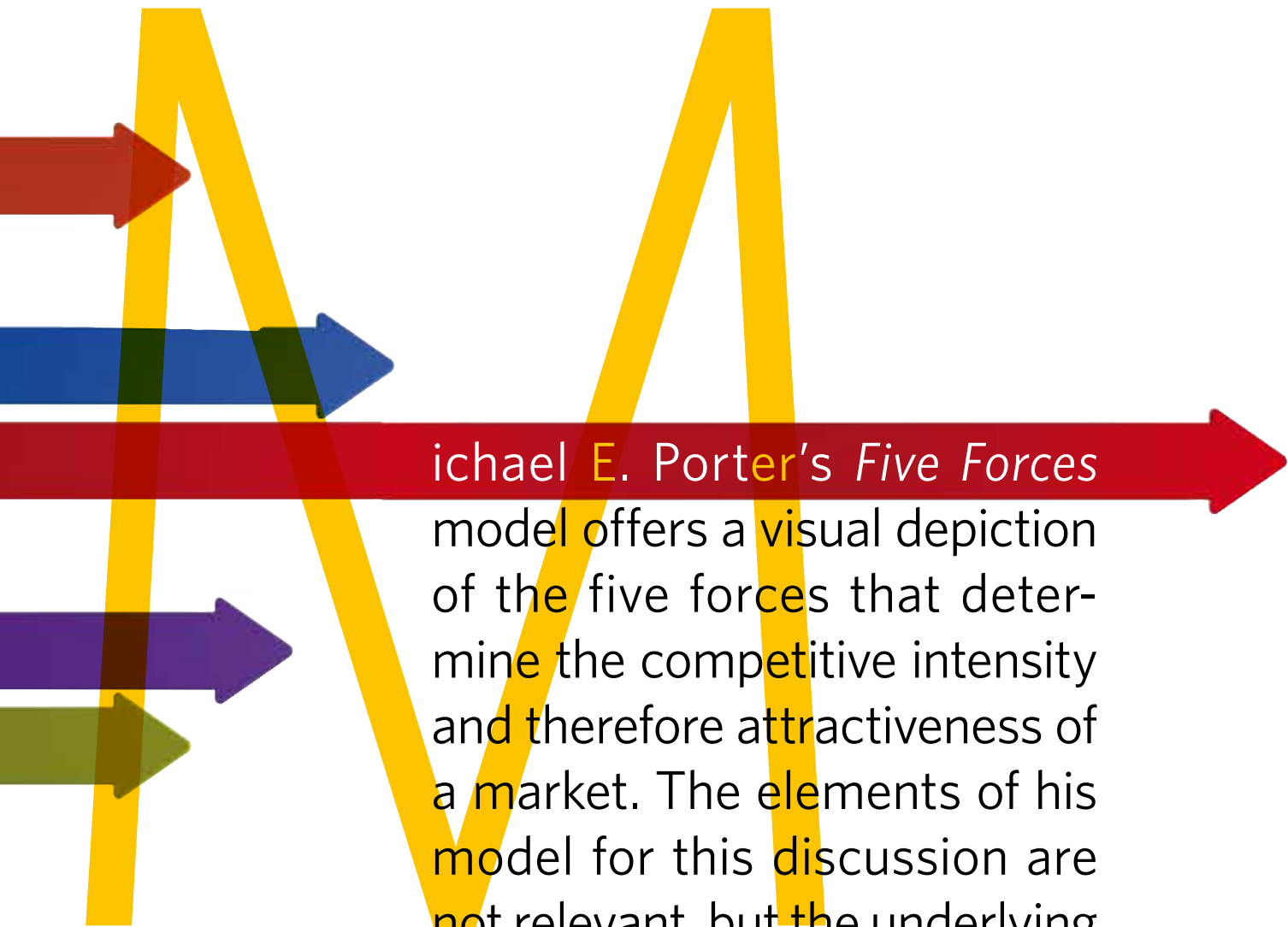




A New Set of Forces

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Michael E. Porter's *Five Forces* model offers a visual depiction of the five forces that determine the competitive intensity and therefore attractiveness of a market. The elements of his model for this discussion are not relevant, but the underlying principle of the model is—forces can be self-correcting. Any imbalance in one element tends to motivate businesses to take some action to take advantage of the imbalance—e.g., entering

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or leaving the market or raising or lowering prices. The result is that eventually, the industry will approach a state of equilibrium (pure competition) where profits are minimal. A more simplistic example of self-correcting forces is the venerable law of supply and demand. Changes in the aggregate supply or demand of a product tend to affect the price demanded or the amount of the product offered for sale. The ultimate example of self-correcting forces is the free market itself.

Unfortunately, macroeconomic principles do not always prove useful at the microeconomic level. Performance-based acquisition appears to be one of those principles that looks good on paper and has proved quite successful in private industry but has had little success in government. Why? The answer is simple. The inherent self-correcting force that makes performance-based efforts successful in industry (the profit motive) has no influence in government.

Grab any article on any topic in the acquisition profession, and it is likely that the author advocates a greater emphasis on performance-based acquisition. The advocating position is an easy one to take. From a theoretical perspective, it is as hard to argue against performance basing as to argue against clean air. It sounds so good, in theory. In reality, the potential benefits of performance basing—i.e., the potential for achieving better outcomes—do not appear to be of sufficient “personal” value to government decision makers to justify the additional upfront costs and effort of creating a well-designed, performance-based acquisition. As the principal-agent problem suggests, people will act within the limits of their discretion to advance personal interests, even when these acts tend to minimize organizational interests. The potential benefits to the organization are simply not sufficiently compelling to serve as a self-correcting force. Decision makers err on the side of caution and revert to time-tested, comfortable habits in planning and contracting.

Since the 1990s, the federal government has been moving toward a results-oriented, performance-based environment. Under performance-based contracting, agencies describe the outcomes desired, not how to achieve those outcomes. Performance basing is prefaced upon an ability to clearly define objectives, unambiguously measure progress, honestly evaluate performance in reaching those objectives, and structuring an environment that aligns the government’s objectives with industry objectives—i.e., profit. Throw in a few cups of good communication, and you have a recipe for success.

Despite the great body of anecdotal evidence that performance basing can be a force for good, the federal government has never achieved the Office of Federal Procurement Policy (OFPP) goal of 50 percent of all federal acquisitions structured as performance-based. Anecdotally, agencies have realized measurable cost avoidance by applying performance basing in appropriate situations. Some claims are as high as 12 percent, yet there still exists a prevailing lack of confidence in the efficacy of performance basing, particularly when we

The use of the term “best practice” needs to be purged from the federal lexicon. On its face, the term presumes that this practice is best and no other will do. This leads to a propensity to try to force a square peg into a round hole. One-size-fits-all solutions seldom fit everything. From a pure use-of-language perspective, the terms “promising practices” or “proven practices” might serve us better.

deviate from the standard candidates such as janitorial and lawn maintenance services. Upfront costs are perceived to be larger than they truly are and serve as a substantial barrier.

An unemotional, rhetoric-free analysis of the topic strongly suggests that performance basing is not a good candidate for adoption by the federal government as a “best practice.”

- The goals of industry and government are different.
- In industry, coming in under budget leads to better bottom lines and rewards. In government, not spending your entire program budget leads to smaller future budgets and the perception of punishment.
- Government agencies are constrained by the Federal Acquisition Regulation (FAR), industry is not. Industry can enter into strategic alliances that are prohibited to agencies because of competition and conflict-of-interest rules.
- Performance-based acquisitions and the performance-based contracts that support them demand a level of government oversight that is greater than that of other constructs. In times of diminishing budgets and workforce, committing agency resources to a methodology that does not have an unambiguously successful track record is difficult for decision makers.

The goals of government and business always will differ, although at times they may be compatible. Adjusting the goals of government clearly is not an option. Therefore, senior government leaders must acknowledge this inherent difference and eschew mandating upon the agencies common business practices without clear evidence of their appropriateness for government. From this perspective, the OFPP goal of 50

percent is laudable, reasonable, and something we should all strive to achieve, although it appears unlikely to be obtainable.

Personally, I am a staunch advocate of performance basing. My experiences have been very positive, and I have yet to find a valid government need that could not be expressed in terms of measurable outcomes. Nonetheless, bringing my immediate colleagues into the fold has often been reduced to an argument of "Try it; you'll like it." In this aspect, performance basing is similar to broccoli; you really like it or think you hate it.

To add insult to injury, savings realized in performance-based acquisitions can be recovered to satisfy other needs, but the facilitator and the benefactor are seldom the same. In a typical scenario, Manager A constructs a highly effective performance-based acquisition that results in savings. The agency head then applies these savings to the needs of Manager B. Then, having once demonstrated an ability to realize cost savings, the expenditures in the year of execution become the baseline for the out years. All these decisions are proper from the perspective of the agency. Nonetheless, the motivation for Manager A to act in like fashion in the future is diminished. The forces that normally drive performance basing (cost savings and better use of agency funds) act against the practitioner.

The FAR in itself is not a barrier to performance basing; however, the competition rules do prevent government agencies from taking that next step toward establishing strategic alliances. A true strategic alliance, in the business sense, between the government and a for-profit organization, is replete with opportunities of running afoul of procurement integrity statutes and crossing the line of inherently governmental activities. The FAR and government policy encourage partnerships between business and government, but only within a very narrow path.

Successful performance basing demands increased vigilance and surveillance by the government. This tends to be labor-intensive and demands a specific acquisition profession-related skill set for the non-acquisition personnel who typically perform that oversight. As budgets get tighter and workforces get smaller, functional leaders are under pressure to concentrate on core missions. This makes performance basing even less attractive from the perspective of the functional leader.

So if performance basing is not appropriate for government, is there another practice it should adopt that has the potential for similar outcomes, i.e., reduced costs, increased performance, or both? The answer to this question is, "Not likely." If other practices existed, they would be evident within a free market replete with organizations seeking competitive advantage.

Are there other actions Congress or the senior defense leadership can take that will make adopting performance basing a more attractive (or at least a more palatable) option to acquisition practitioners? The answer to this question also is, "Not likely." A top-down, compliance-driven approach is very


seldom successful. As John Kotter, Edgar Schein, Peter Drucker, and others have suggested on many occasions, organizational culture can be a daunting barrier to change. Holding leaders accountable for the decisions of subordinates is reasonable, but the influence of senior leaders is greatly diluted when it must permeate multiple layers of management. The influence of the revolutionary leader's vision is even less influential when risk-averse juniors make decisions that are legal, within their discretion, and defensible. The challenge for the senior is to demonstrate to the junior decision maker that the new way of doing business is consistent with the junior's enlightened self-interest. A bottom-up, change-of-culture approach might prove successful over time, but it has not worked so far.

Performance basing also tends to favor large businesses, which is inconsistent with the government's desire to give preference to small business, where practical. There is great comfort in the government telling you what to do and how to do it when hundreds of years of tradition and case law tell you that if you follow these instructions exactly, you will get paid regardless of outcomes. If the small business assumes the mantle of risk-taker and innovator, the likelihood of getting paid is less assured. Small businesses with limited capacity to absorb losses will eschew competing for performance-based work (which pays for the greater potential for innovation with an increase in uncertainty) for more traditional constructs.

Contract type is also a factor in the large vs. small competition. Performance-based, firm fixed-priced contracts, contingent on outcomes in the distant future (distant for small businesses fighting to survive into the next quarter) tend to favor large businesses with greater capacity for assuming uncertainty, the cost of money, and financial risk.

Multiple instances of poor execution of performance-based acquisitions over the years are the final nail in the reputation of performance basing. Since bad examples tend to be emphasized and good examples ignored in the media, the bad becomes dominant in the minds of the public and performance basing becomes something to avoid in the minds of the government manager—in the same vein as conferences are quickly becoming taboo because of the bad acts of a few.

In summary, we have a concept that is very difficult to put into practice and that, when attempted, has a high failure rate in an environment intolerant of failure. Is performance basing, therefore, doomed for the scrapheap of well-intentioned ideas? Hopefully not, but the evidence is mounting. After decades of practice, it has yet to enter the mainstream of the acquisition profession.

Is there an alternative to performance basing that is influenced by natural self-correcting forces that would be viable for the federal government? The answer is not in this article. Consider this a plea to bring forth your ideas for discussion. 

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